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Financial Markets

Irving Trust

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The week was tense, to put it mildly, with market rates uniformly higher, a reflection of the record $8.9 billion increase in M1B announced last Friday. Many market participants expected that a large portion of the increase would be reversed this week and next, and their apprehensiveness could be seen in the nervous quality of trading. Also contributing to the malaise was the fact that the generally small and technical nature of Federal Reserve open market operations during most of the statement week ended Wednesday left many participants much less confident than usual about where Federal funds "ought" to trade.

The already muddy waters were churned further on Thursday, when shortly before noon, with funds trading at 9 7/8%, the Fed entered the market to arrange five-day reverse repurchase agreements for the account of a foreign customer. The move hit the market like a bolt out of the blue, since the Fed rarely arranges such transactions in the market. The funds rate had been rising gradually over several days, and many market participants were hoping for some overt move by the Fed to counter the firmness; what they got instead was, as one trader said, "enemy fire." As a result, rates backed up immediately, with 90-day Treasury bills jumping about 40 basis points, and the long bond dropping over a point. Later, some of the rate increases were pared back as the market recovered its composure somewhat.

It is certainly true that the unusual transaction indicated that the Fed did not wish to add reserves by executing the order internally. However, it is essential to put some perspective behind the operation. Assuming that the Fed's reserves projections--like our own--pointed to an approximate reserve balance for the statement week starting Thursday, no open market operations were called for. Most likely the order stemmed from the desire of a foreign central bank (probably the Bundesbank) to acquire dollars for use in supporting its own currency, and it could obviously have been executed internally. To do so, the Fed would have offset the order against other temporary investment orders of foreign customers. This would have reduced the net volume of foreign orders executed with the Fed, thus producing greater reserve availability. But then, other things being equal, the Fed would have had to counter the increased availability—most likely through its own reverse RPs. Considering the impact that the customer order had on the market, psychological devastation would have followed system reverse RPs. Instead, it appears that the Fed did its best to demonstrate to the market that the transaction--though unusual--was merely a technical adjustment with no policy significance. Apparently, the market is coming around to the same view, for when the Fed arranged a similar transaction on Friday, reaction was minimal.

If this interpretation is accurate, then the Fed still has given no sign of firming its policy stance in the aftermath of last week's leap in the money supply. Most likely, at this stage the Fed--like everybody else—is waiting to see whether the rise washes out in coming weeks.

William C. Melton

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Market Yields

	8/22/80	Week Ago	Year Ago
Prime Lending Rate at Irving Trust Company	(Noon)		
Short-term loans to substantial depositors with highest credit rating	11.25%	11.00%	12.00%
Effective since	8/22/80		
Discount Rate at Federal Reserve Bank	10.00	10.00	10.50
Federal Funds	10.13	9.00	11.01
Repurchase Agreements	9.50	8.38	10.35
U.S. Treasury Issues			
Bills			
3 months	10.02	8.54	10.00
6 months	10.70	8.96	10.25
1 year	11.02	8.99	10.24
Coupons			
2 years	11.10-	10.08	9.74
4 years	11.25	10.14	9.20
7 years	11.30	10.63	9.18
10 years	11.26	10.89	9.15
Long Bond	11.21	10.88	9.05
Negotiable Certificates of Deposit-Secondary Market			
1 month	10.30	9.45	10.82
3 months	10.75	9.60	11.09
6 months	11.00	10.00	11.25
1 year	11.50	10.25	11.13
Banker's Acceptances			
1 month	10.20	9.30	11.00
3 months	10.50	9.60	11.20
6 months	10.90	10.00	11.47
Eurodollar Deposits			
1 month	10.38	9.50	11.56
2 months	10.75	10.00	11.88
3 months	11.13	10.38	12.00
Commercial Paper - Prime Names			
Directly placed by:			
Finance Companies			
1 week	9.64	8.88	10.50
1 month	9.95	9.13	10.55
3 months	9.99	9.00	10.13
Bank Holding Companies			
1 month	9.45	9.00	10.55
Dealer Placed:			
3 months	10.25	9.13	10.70
New AA Corporate Utility Bond	12.75	12.75	9.75
Tax Exempt			
6 month Project Notes	6.40	4.60	5.20
1 year AAA Bond	5.90	5.10	N/A
5 year AAA Bond	6.20	5.45	N/A
20 year AAA Bond	8.20	7.80	5.90

This information represents prevailing market yields.
It should not be construed as an offering.
All yields are on the offered side of the market.

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